Treasury Select Committee: Inquiry into student loans and the taxation of graduates

The Evidence Submission: Question by Question

1. Should a student loan incur interest?

There are several things for the Committee to consider here:

- access to student finance for Muslim students
- The psychological burden of interest on Plan 2 graduates
- The economic function of student loan interest for higher earning graduates.

Currently, student loan interest presents a huge psychological burden to graduates on Plan 2, many of whom see their loan balances growing faster than they are able to pay them off. We welcome the government's recent commitment to capping interest on Plan 2 loans. Particularly pernicious is the so-called "maternity penalty" whereby graduates incur interest while their earning capacity is limited on maternity leave, and they are not making student loan repayments. This will have especially negative impacts on the students from lower socioeconomic backgrounds, who we know to be more debt-averse than wealthier peers. (Callendar; 2008: https://www.tandfonline.com/doi/abs/10.1080/03075070802211802).

Furthermore, the accrual of interest makes it difficult for Muslim students whose faith prevents them from dealing in interest to access higher education. Successive governments have committed to bringing in Alternative Student Finance, but so far every one of them has faltered on actually doing so. We now need secondary legislation to be brought to ensure the government follows through on their commitment. (https://www.gov.uk/government/publications/alternative-student-finance/alternative-student-finance).

Economically, however, there is a function for student loans to bear interest as it prevents higher earners "tapping out" of the system earlier than middle- and lower- earners.

Previous NUS modelling has suggested increasing available funding at minimum cost to government by requiring all graduates to pay back their loan for 30 years, thus ensuring higher-earners pay back more than lower- and middle-income earners, subsidizing maintenance grants for students from the poorest backgrounds (https://londoneconomics.co.uk/blog/publication/modelling-a-stepped-repayment-system-for-student-loans-in-england-april-2025/)

1b. Should the interest on a student loan be dependent on income?

NUS has commissioned modelling of a "stepped repayment" system with London Economics and HEPI, which delivers a more progressive fix to Plan 2 student loans and results in lower lifetime repayments for middle-earning graduates, with a more progressive distribution of payments across income deciles. This comes at little cost to the Treasury, due to the use of an income-contingent interest rate to ensure that higher earners keep paying back into the Treasury.

1c. Should the interest on a student loan be fixed to RPI, CPI or another measure?

RPI is the Retail Price Index, which delivers a higher interest rate because it includes housing costs. CPI is the Consumer Price Index, which is based on buying the things you need, excluding housing.

CPI is a much more standard measure of interest, and RPI is no longer used as a national statistic, so if interest is to be charged and the options are either RPI or CPI, we recommend standardising CPI across student loans.

However, NUS' modelling uses a real interest rate which is overall lower than the current Plan 2 or Plan 5 set interest rates, with loans accumulating 3% during study and 0-3% depending on graduates' earnings once study is complete.

2. Are interest rates above the rate of inflation on a student loan fair?

It feels inherently unfair that a finance product designed to enable access to education leaves students with lifelong debt, and that is in part due to interest rates.

NUS' modelling has revealed that the Treasury takes in over £600M per cohort on Plan 2 student loans, in part due to high interest, meaning that the government is in effect making a profit on graduates. We believe that this is too high, and believe in a publicly-funded higher education system.

3. Was it fair for the government to block the interest rate on student loans from going negative when the measure of index the loan was pegged to went negative?

No. We believe that if loans are to be tied to economic measures, these should be coherent.

4. Should student loans be branded as loans, or as something else? Does calling a student loan a loan exacerbate the dissatisfaction with the product among users?

We do not believe that this Inquiry should simply rebrand student loans as something else without addressing the underlying problems with them. We believe that the key thing that is exacerbating the dissatisfaction with the "product" is that the government changes the terms retroactively, to the huge disadvantage of the majority of its users.

There have been ongoing attempts to "demystify" the student loans system, which is in itself a sign of a system which has become unwieldy and complex. Any financial product which is meant to act as an enabler of access to higher education should be clear enough to be understood by the people signing up to its contracts, which in this case are, in majority, 17 year olds with little experience of applying for and signing up for financial products.

We are not against flexibility in student loans, but we do not want to see students disadvantaged unfairly.

5. What proportion of a student's university education should be funded by the student versus being subsidised by the state?

NUS' modelling shows that, following cumulative changes to Plan 2 loans in the government response to the Augar Review and then, more recently, the repayment threshold freeze, the government now generates an estimated net surplus to the Exchequer of £679M per cohort. This brings the balance of state and individual contributions to -5%:105%.

We believe that education is a public good, and we should all be working toward a future where the state should fund education through progressive taxation.

Right now, we want to see a fairer balance between state and student payments, a re-examination of the role of teaching grants in this balance, and see the burden of repayment lifted from the poorest graduates.

We believe that the fairest way to reduce the debt burden for current students, and to rebalance the cost of education for students and the state, is to bring back maintenance grants for the poorest students, regardless of course choice.

6. Should the terms of a student loan be able to be changed by government once the loan has been taken out?

We are not against flexibility in student loans if it is well-managed.

We believe there should be periodic review, that students are aware of when signing up. It should be overseen by an independent body, which aims to curtail the ability of governments to use the student loan book as political football.

7. Does the process around student loans provide enough information, in a clear and fair form, given that this may be the first credit contract for many people?

In 2012, students were told that their monthly loan repayments would be comparable to a phone contract: https://www.bbc.co.uk/news/articles/cy5706ep1l3o.

Student loans are often the very first financial contract that a young person will sign, and their terms should be absolutely explicit, including up front the knowledge that those terms can be changed.

The lack of information is compounded for those students who are the first in their families to enter higher education and cannot rely on the personal experience of family members who have gone through the student loan application and repayment process. There should be significant investment in financial education in schools and Information, Advice and Guidance, not just at the point of application to higher education, but embedded in the curriculum at every stage.

8. Should loans from the Student Loan Company be compliant with FCA rules and principles and the Consumer Duty?

Yes. If student loans are to be a trustworthy financial product, they should be regulated as such.

9. Does changing the terms of a government loan contract once it has been entered into erode trust in Government?

Yes.

When students enter into a loan agreement to fund their university studies, it is by and large presented as the sole way to fund their studies – and indeed, there are no competitor finance products – and so they are not able to engage with the terms of the loan and are not aware that it will likely change.

The considerable outrage over the Plan 2 student loan repayment threshold freeze shows the strength of feeling about retroactive changes to student loans, and the impact that this has on a young, politically active voting cohort.

10. Might changing the terms of a loan once it has been taken out affect future take up of student finance through lack of certainty in the loan product?

Given a lack of alternative student finance products, and the relative lack of affordability and availability of a commercial loan, we do not predict that the current lack of faith in the student loan system will damage uptake, as students do not have other realistic options.

11. Are there examples of government unilaterally changing the terms and conditions of finance provided to companies or pensioners or other groups in the economy?

We do not believe there to be, but there are cases where other groups have been subject to financial mistreatment, and Ministers have intervened to rectify the situation.

For example, families who have struggled to access Premium Bonds following bereavements have been compensated for the delays they faced.

Students who face delays and sudden changes to their loan payments or even their loan being withdrawn with a repayment order, have not received anything to compensate them for the stress and uncertainty.

12. Should the incomes of higher-earning graduates be used to subsidise the loans of lower-earning graduates?

We believe in a progressive system, where the highest earners pay more into the system, to support those who earn less.

NUS' modelling is based on this, where those graduates who go on to have the very highest salaries will then subsidise maintenance grants for working class students.

For Plan 2 graduates, we, alongside London Economics and HEPI, have modelled a progressive alternative to the current repayment system. This uses a stepped repayment system which starts as soon as a graduate earns enough to pay taxes, resulting in a lower lifetime repayment for almost all graduates and a progressive distribution of repayments across earnings deciles. You can read the full proposal here (Scenario 4).

For current students, the simplest way to both reduce the burden of student loan debt and to alleviate student poverty is to reintroduce maintenance grants. NUS and London Economics have modelled a stepped repayment plan for these students which could bring back grants at limited cost to the Exchequer, whereby higher earners are kept in the repayment system for longer in order to pay back a greater proportion of their debt, and therefore use this to fund grants for the poorest students while they study. The full modelling can be viewed here.

13. How does the student loan system interact with the taxation system, including marginal rates?

A middle earning graduate (£28 - £50k) on a Plan 2 loan faces a 40%+ marginal tax rate, which is meant to be for the highest earners.

This particularly bites in graduates' 30s and 40s, where they hit higher earning potential, but are constrained by higher "taxes" thanks to student loans, therefore struggle to maximise pension savings, buy houses and have the markers of financial stability that other generations have enjoyed.

14. Do student loans currently deliver equitable shares of burdens and benefits between generations?

We believe in lifelong education and opportunity for everyone to study, at any time in their lives. Although currently the majority of student loan holders are young, this does not mean everyone who holds one is.

However, it is useful to compare the treatment of pensions politically to the treatment of student loans.

Due to the 'Triple Lock,' pensions are guaranteed to keep pace with rising costs and inflation.

However, the most recent repayment threshold freeze for Plan 2 student loans was announced in November 2025 for three years, when it was intended to also rise with inflation. The freezing of the threshold, coupled with post-Augar Review changes to Plan 2 loans, means that average repayments for a male graduate are expected to be £13,400 higher and £16,900 higher for a female graduate. These impacts are primarily felt by lower- and middle-earning female graduates, with the highest-earning graduates largely unaffected. See Scenario 2 for the full modelling.